An individual investor's guide to choosing a discount broker

Not all discount brokers offer the same discount. And the best discounter for one trade may not be the best for a different type of trade. What's an investor to do? Read on . . . .

By Mark D. Coler

Dealing with brokers is a fact of investment life that individual investors can't change. How much it costs to deal with them is something an investor *can* change.

Discount brokers can offer investors tremendous savings. Which is why discount brokerage is one of the fastest-growing segments of the securities industry. The ranks currently include not only some very large firms, but thousands of banks and thrifts that are offering discount-brokerage services.

Of course, a discount broker is not the same as a full-service broker (I refer to them as full-commission brokers). The most significant difference is that you will not get recommendations from a discounter. In addition, they generally do not offer tax shelter partnerships and almost never offer new stock issues.

On the other hand, they do provide many of the services that a full-service broker provides, although a single discount broker will not offer all of these options. Most discounters, for instance, offer free safekeeping facilities, toll-free telephone numbers, monthly statements, individual trade confirmations, every type of order, plus IRA and Keogh retirement accounts. Many offer dividend payment and reinvestment, current news on stocks, integrated cash management accounts and many other services. All brokerage firms must carry the minimum $500,000 Securities Investor's Protection Corp. insurance, and some discounters offer additional insurance to $2 million or more.

And most discounters, of course, can offer a substantial savings over full-service brokerage commissions.

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The savings

How much of a savings can you really expect? If you look at the average discounter, you could save between $25 to $75 each way on a 300-share trade. But commissions vary widely, depending on the broker and the type of trade. For instance, the typical full commission on 200 shares of a $40 stock would be $144. Haas Securities Corp., New York, and Pacific Brokerage Services, Beverly Hills, Calif., however, would charge $25. Clayton, Polleys & Co., Boston, would charge $40. In fact, the thirty least-expensive discount brokers came in at $54 or less. On a different trade, 500 shares at $10, the typical full commission would be $130, compared to York Securities' $35. For this trade, the thirty least-expensive brokers came in at $53.40 or less.

At this point, some investors ask: "What's the catch?" For the investor, there is none. The trades are executed just as quickly, and in the same manner as trades from all other brokers.

Then where, you ask, do the savings come from? Most are from the economies of a high trading volume, cutting out the commissioned salesman and chopping overhead. One large discounter attributes 30% to 40%

The 30 least-expensive discounters for 200 shares at $20 per share

Pacific Brokerage Service	$25.00
Haas Securities Corp.	25.00
Bevill, Bresler & Schulman, Inc.	30.00
Odd Lots Securities, Ltd.	30.00
J. Alexander Securities, Inc.	30.80
Pace Securities	35.00
Liss, Tenner & Goldberg	35.00
The Wall Street Discount Corp.	35.00
Waterhouse Securities, Inc.	35.00
York Securities	35.00
Brown & Company	35.00
Seaport Securities Corp.	35.00
Discount Brokerage Corp.	35.00
Exchange Services, Inc.	35.00
First Heritage Capital Co.	36.00
Schochet Securities, Inc.	38.00
Tradex Brokerage Services, Inc.	38.00
The Stock Mart	38.50
Brenner Steed, Inc.	38.50
Arnold Securities, Inc.	38.50
First Birmingham Securities Corp.	38.50
Barry W. Murphy & Co., Inc.	38.50
Baker & Co., Inc.	38.50
Dominick & Dominick, Inc.	39.00
Grimm & Davis	39.00
Thomas F. White & Co., Inc.	40.00
Heritage Investment Securities, Inc.	40.00
Guardian Discount Securities	40.00
Kashner Securities Corp.	40.00
Collins Brokerage Services, Inc.	40.00
Clayton, Polleys & Co., Inc.	40.00
The Pennsylvania Group	40.00
Typical full commission	**$92.00**

The 30 least-expensive discounters for 500 shares at $20 per share

Pacific Brokerage Services	$40.00
Brown & Co.	50.00
Seaport Securities Corp.	50.00
Odd Lots Securities, Ltd.	52.90
York Securities	52.91
First Heritage Capital Co.	54.00
Waterhouse Securities, Inc.	61.30
Discount Brokerage Corp.	61.70
Douglas Stewart, Inc.	62.50
R. F. Lafferty	62.50
The Wall Street Discount Corp.	62.50
Bevill, Bresler & Schulman, Inc.	62.50
Haas Securities Corp.	62.50
Whitehall Securities, Inc.	62.50
Ovest Securities, Inc.	65.00
Liss, Tenner & Goldberg	65.00
LaSalle St. Securities	65.00
Stock Cross, Inc.	67.50
Carnegie Investor Services, Inc.	68.50
Russo Securities, Inc.	70.00
Clayton, Polleys & Co., Inc.	70.00
Andrew Peck Associates, Inc.	70.00
Tradex Brokerage Services, Inc.	70.00
Allied Securities Corp.	70.50
Barry W. Murphy & Co., Inc.	70.50
J. Alexander Securities, Inc.	70.50
Exchange Services, Inc.	72.50
Little & Co.	74.00
Pace Securities	75.00
Schochet Securities, Inc.	75.00
Olde Discount Stockbrokers	75.00
Typical full commission	**$195.00**

of the savings to cutting out the commissioned salesmen, 5% to 10% to eliminating a research department, and the balance from eliminating middlemen and services that most customers don't use.

Comparison shopping: It's not easy

A firm that calls itself a discount broker won't necessarily give you a good discount. The range of pricing variation among discount brokers is enormous—much greater than conventional brokers.

Practically every discounter has a unique commission structure—better for some traders, worse for others. Some firms will increase or reduce their scheduled commission if total trading volume exceeds a specified level, if you place an order before a certain time, if you use a certain type of trade, if you buy and sell on the same day, and so on.

Having studied every discount commission schedule in the country that my firm could lay its collective hands on, I can state categorically that there is no such thing as the best discount broker—or the cheapest.

What's an investor to do?

First, you must analyze your trading pattern—the number of shares and the price per share that you most frequently trade. Then check the commission schedules of a number of discounters; the schedules are available from the firms upon your request.

What you are looking for is a broker whose commission pattern matches your transaction pattern. There is a method to their madness, and most investors can pick a group of firms that is clearly best for their trading pattern.

In general, discounters can be divided into two groups based on how they arrived at their commission schedules. The *valuebrokers* (our term) charge in the traditional manner, by fixing their rates in proportion to the value of the trade. *Sharebrokers,* on the other hand, structure their commissions on the number of shares in the transaction. Whether those shares cost $25 or $100, the charge will be the same.

Both types of brokers provide lower relative commission costs as the value of the trade increases. But a sharebroker who charges per unit is generally cheaper if you are buying high-priced stocks. Valuebrokers, on the other hand, are cheaper if you deal mostly in low-priced stocks. If you are an active trader and deal in both types of trades, you may want to consider setting up two different brokerage accounts.

Valuebrokers include Fidelity/Source, Boston, Charles Schwab & Co., San Francisco, and Kall & Co., Los Angeles. Sharebrokers include Kennedy, Cabot & Co., Beverly Hills, First National Brokerage Services, Om-

The 30 least-expensive discounters for 200 shares at $50 per share

Haas Securities Corporation	$25.00
Pacific Brokerage Services	25.00
Bevill, Bresler & Schulman, Inc.	30.00
Pace Securities	35.00
Seaport Securities Corp.	35.00
The Wall Street Discount Corp.	35.00
Exchange Services, Inc.	35.00
First Heritage Capital Co.	38.00
Clayton, Polleys & Co., Inc.	40.00
Heritage Investment Securities, Inc.	40.00
Brown & Co.	41.00
Liss, Tenner & Goldberg	42.00
Stock Cross, Inc.	42.00
Odd Lots Securities Ltd.	42.90
Russo Securities Inc.	45.00
York Securities	46.20
Bruno, Stolze & Co., Inc	50.00
Burke, Christensen & Lewis Securities, Inc.	50.00
Douglas Stewart Inc.	50.00
First National Brokerage Service	50.00
Ovest Securities	50.00
R. F. Lafferty	50.00
Rose & Co. Investment Brokers, Inc.	50.00
St. Louis Discount Securities, Inc.	50.00
Whitehall Securities, Inc	50.00
Waterhouse Securities	52.80
Discount Brokerage Corp	53.90
Andrew Peck Associates, Inc.	54.00
Carnegie Investor Services, Inc.	54.00
LaSalle St. Securities	54.00
Tradex Brokerage Services, Inc.	54.00
Typical full commission	**$168.00**

The 30 least-expensive discounters for 300 shares at $75 per share

Pacific Brokerage Services	$25.00
Seaport Securities	35.00
Bevill, Bresler & Schulman, Inc.	37.50
Haas Securities Corp.	37.50
The Wall Street Discount Corp.	37.50
Pace Securities	45.00
First Heritage Capital Co.	46.00
Brown & Co.	49.00
Whitehall Securities, Inc.	50.00
Clayton, Polleys & Co., Inc.	50.00
Russo Securities, Inc.	50.00
R. F. Lafferty	50.00
Stock Cross, Inc.	50.50
Douglas Stewart, Inc.	58.50
Ovest Securities, Inc.	60.00
Little & Co.	60.00
Heritage Investment Securities, Inc.	60.00
Andrew Peck Associates, Inc.	61.00
Liss, Tenner & Goldberg	63.00
LaSalle St. Securities	66.00
Carnegie Investor Services, Inc.	67.00
York Securities	68.00
St. Louis Discount Securities	75.00
Tradex Brokerage Services, Inc.	75.00
Icahn & Co., Inc.	75.00
Bruno, Stolze & Co.	75.00
Rose & Co. Investment Brokers, Inc.	75.00
Burke, Christensen & Lewis Securities, Inc.	75.00
First National Brokerage Services	75.00
Olde Discount Stockbrokers	80.00
Richard Blackman & Co., Inc.	80.00
Schochet Securities, Inc.	80.00
Typical full commission	**$242.00**

aha, and The Wall Street Discount Corp., New York. Valuebroker/sharebroker combinations include Quick & Reilly Inc. and Discount Brokerage Corp., both based in New York.

The accompanying tables will give you an idea of the commissions of the thirty least-expensive discounters for several types of trades. They are based on a 1983 survey by Discount Brokerage Advisory Services.

If you buy over-the-counter stocks, the analysis is a bit more complicated. This market consists of dealers who agree to buy and sell the stock at a specified price. They are linked through NASDAQ, the National Association of Securities' Dealer's Automated Quotation System.

Where commissions are charged in a normal manner, your commission savings on over-the-counter stocks should be as great as in exchange trading. However, these costs are often calculated differently—the charge will be a "markup" instead of a commission. That is, instead of paying $30 per share plus commission, you will pay $30 and a quarter—a markup of a quarter point, or 25¢ per share. To determine the savings, you must determine the size of the markup, which is not always disclosed on your brokerage statement. If it is not disclosed, you should ask, and compare it with the charges for discount brokers. As a rule of thumb, it will have to be less than one-eighth of a point to be competitive with the better discounters charging on the normal commission basis.

In some instances, especially with large, full-commission brokers, you may be buying from a broker that makes a market in that OTC stock and has sold it to you from inventory. If this is the case, and he has sold it to you at the "inside" price—the price at which it will be sold to other brokers—then you may do better in this trade dealing with the full-commission broker. Any other broker would have to pay this price and will charge you a commission, as well. This is a tough area to assess, and I can't offer any opinion.

There is one other area in which discounters are not necessarily a bargain, and may even be more expensive than a full-commission broker. That area is very small transactions, where, for instance, the value is under $2,000, or you buy in lots of under 100 shares. While many discount firms have low minimums, so do some conventional. In this range, no brokerage firm can make a profit, and the minimum covers the paperwork, mistakes, overhead and time costs. Thus, there are no savings that a discounter can pass on.

Other considerations

Price, of course, isn't the only factor to think about when choosing a discounter, particularly if you aren't an active trader. Other considerations include:

- Size: Some investors prefer dealing with large firms, although all firms carry the $500,000 SIPC insurance. Generally, the larger firms don't offer the lowest commissions, but there are some exceptions—and plenty to choose from.
- Location: Many people like to deal with a firm that is nearby. However, since it's a telephone business, it shouldn't really matter, and with a toll-free 800-number, you can call across the country for less than the cost of a local call.
- Banks vs. independents: Banks provide the advantage of convenience, with the ability to link a brokerage account to a bank account. You can also have stock certificates delivered directly to your branch. On the other hand, some investors feel independent brokers are more experienced. And they offer the lowest commissions overall.
- Other services: Discount brokerage is not the opposite of full-service—discounters do offer services, such as IRAs, money funds, and even stock reports. However, each discounter has a different menu. You will have to ask what is available.

Should you switch?

While most investors would be better off using a discount broker for at least some of their trades, some would not.

If you want or need regular advice about your investments, stick to a full service firm. In addition, some investors place a premium on the backup role brokers can play, preventing blunders in a particular stock. But make sure you are getting what you are paying for—if your current broker is just a neutral order-taker, why pay extra?

Assuming that you are otherwise satisfied with your current full-commission broker, here are a few good reasons to stick with him:

- You trade so little that it doesn't make much difference: The savings may not justify the trouble of a move.
- Your average trade size is small: As explained above, this is the one type of transaction where large savings may not be possible.
- Your full-commission broker runs a portfolio for you on a discretionary basis, you never initiate any trades, and his track-record is outstanding: Stick with him—and tell your friends!
- You are in the enviable position described above, except you do initiate some trades on your own: Open a second account with a discount broker exclusively for those trades you initiate.
- You are an options trader dealing only in complex transactions, and you require immediate feedback from the floor: Normal discount brokers are no better equipped to handle this than are conventional brokers. You need a specialized broker. Some discount brokers do specialize in servicing active traders, but we cannot verify that you will receive this type of exceptional service. As an options trader of this type, your best bet may be to negotiate a discount with your current broker.
- Your Uncle George is a broker, he already has your account, and the prospect of Aunt Matilda's stony silence at Thanksgiving dinner if you switched accounts is more than you could endure: Need I say more?

Discounters are not for everyone. But neither are full-commission brokers. Finding the discounter that is right for you will take time, but the savings may prove to be well worth the investment.

An error

The INC magazine discount offer recently mailed to AAII members failed to include the magazine's address. It is:

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